Newfoundland and Labrador Municipal Financing Corporation

Government of Newfoundland and Labrador
Department of Finance

Annual Report

March 31, 2011

Newfoundland and Labrador Municipal Financing Corporation
Annual Report
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September 30, 2011

Honourable Thomas W. Marshall, Q.C.
Minister of Finance
Government of Newfoundland and Labrador
Confederation Building
St. John's, NL
A1B 4J6

Dear Minister Marshall:

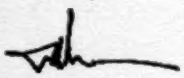
In accordance with Section 13 of the *Municipal Financing Corporation Act*, section 9 of the *Transparency and Accountability Act* and on behalf of the Board of Directors, it is my pleasure to submit the annual report of the Newfoundland and Labrador Municipal Financing Corporation summarizing the Corporation's activities for the fiscal year ended March 31, 2011.

NMFC was established to consolidate the long-term borrowing programs of all municipalities in one central Crown agency. The proceeds of these borrowings were then used to provide long-term financing to meet the capital requirements of municipalities. As most municipal projects were cost shared with the Province, the financing provided was recovered partially from the municipality with the balance, representing the Province's share, paid by the Department of Municipal Affairs.

However, NMFC's mandate and role evolved over time to a situation whereby most municipalities were capable of financing their capital programs independently through financial institutions, primarily banks. NMFC continued to borrow to provide financing for the Provincial share of capital projects for a period of time but, in 2005-06, Government decided it would no longer finance its portion of municipal capital projects but would fund it directly through annual budgetary allocations. Consequently, NMFC discontinued its capital markets borrowing program and its mandate is now to wind up operations when it collects its outstanding loans receivable and repays its outstanding debenture debt. This report outlines the progress made in 2010-11 on the collection of outstanding receivables and payment of outstanding debenture debt.

The Board of Directors has approved the financial statements and information contained in this annual report, and the Board is accountable for the results reported herein.

Sincerely,



Terry Paddon
Chairman of the Board

CORPORATE OVERVIEW

Authority

The Newfoundland and Labrador Municipal Financing Corporation ("NMFC") was established in 1964 and operates pursuant to the provisions of the *Municipal Financing Corporation Act*. NMFC operates with a March 31 fiscal year end and the results of its activities are fully consolidated in the Province's annual financial statements.

Purpose

The Corporation was established to consolidate the long-term borrowing programs of all municipalities in one central Crown agency.

Board Representation and Accountability

The affairs of NMFC are overseen by a Board of Directors appointed by the Lieutenant Governor in Council. All Board members are employees of the Province with the position of Chair held by the Deputy of Minister of Finance. The Board meets no less often than annually and approves its Annual Financial Statements and Annual Report, both of which are then tabled in the House of Assembly by the Minister of Finance. The members of the Board as at March 31 and their positions are as follows:

Mr. Terry Paddon (Chair)
Deputy Minister of Finance

Mr. Brent Meade
Deputy Minister of Innovation, Trade and Rural Development

Ms. Sandra Barnes
Deputy Minister of Municipal Affairs

Mr. Robert Constantine
Assistant Deputy Minister of Taxation and Fiscal Policy
Department of Finance

Mr. Paul Myrden (Secretary)
Director of Debt Management
Department of Finance

Operational and Corporate Information

NMFC has no direct employees as the day-to-day affairs are administered by employees of the Department of Finance. On a quarterly basis, the Province invoices NMFC for its share of the salary costs of the employees who are involved in its administration. Contact information is as follows:

Mailing Address:

Newfoundland and Labrador
Municipal Financing Corporation
c/o Department of Finance
Confederation Building
East Block, Main Floor
P. O. Box 8700
St. John's, NL
A1B 4J6

Office Location:

Debt Management Division
Department of Finance
Confederation Building
East Block, Main Floor
Telephone: (709)-729-6686
Fax: (709) 729-2095

Departmental Website:

www.gov.nl.ca/fin

SHARED COMMITMENTS

An important issue for the Corporation, and the Province as guarantor of the Corporation's debenture debt, is the level of municipal loan arrears. Loan arrears at March 31, 2011 amounted to $4.5 million (2010 - $6.8 million). Historically, the Corporation collected a significant amount of arrears through the interception of municipal operating grants and from allocations from a Reserve Fund established with the Corporation and funded by the Province to assist towns most in need. Subject to the approval of the Minister of Finance, the Fund was periodically allocated as the Department of Municipal Affairs completed negotiations with town councils to determine the eligible levels of financial assistance towards arrears.

Given that NMFC is no longer borrowing and lending the proceeds to municipalities, it does not have sufficient leverage with individual municipalities that can be used to collect outstanding amounts receivable. Consequently, the Corporation is reliant on the Department of Municipal Affairs (MA) to take the necessary action to address outstanding arrears as MA has some additional measures available to address problems arising from the municipalities' inability to pay the arrears, such as the interception of municipal payments and the suspension of further capital funding.

During the 2009-10 year, the Corporation reached an agreement with MA on a strategy to reduce and ultimately eliminate arrears on municipal loans. The components of this strategy were as follows:

- MA would make a lump sum payment of $4 million to the Corporation. This was received in November 2009.
- This $4 million would be combined with existing Debt Relief funding of $1.77 million for a total of $5.77 million available to be applied against arrears.
- The Corporation would discontinue the application of late fees on accounts in arrears effective November 1, 2009.
- MA would negotiate repayment arrangements with communities in arrears and provide the Corporation with periodic direction on the application of the $5.77 million to individual accounts in arrears.
- MA would monitor active loan payments and implement additional collection efforts as required.

In addition to the agreed payment of $4 million, a further $1 million was paid by MA to the Corporation in March, 2010 for future application against arrears bringing the total available to $6.77 million.

During 2010-11, MA entered into repayment arrangements with ten municipalities in arrears with NMFC. As a result of these negotiations, as at March 31, 2011 a total of $46,220 in late fees relating to five municipalities was allocated from the Reserve Fund and applied to their arrears.

Also in 2010-11, $1,997,271 was allocated from the Reserve Fund and applied to arrears relating to two municipalities that had gone through amalgamation during the fiscal year and were not part of the agreements that MA had entered into with the ten municipalities.

During 2010-11, a total of $2.04 million has been applied to outstanding loan balances, leaving a balance in the reserve fund of $4.73 million to be applied in future years.

HIGHLIGHTS AND ACCOMPLISHMENTS

Government has decided that, going forward, the Corporation will not be used as a vehicle to finance the Province's share of the cost of municipal capital projects. Since most of the Province's municipalities already arrange long-term financing from the banks and other financial institutions, the Corporation is in the process of winding up operations as it collects the loan portfolio and retires its debenture debt and this process continued during the fiscal year.

Collection of outstanding loans receivable amounted to $20.5 million as the Corporation's loan portfolio was reduced from $106.7 million to $86.2 million. During the same period, outstanding accounts receivable decreased from $6.8 million to $4.5 million, primarily owing to the $2.0 million allocated from the Reserve Fund and applied to arrears in 2010-11.

The net debenture debt of the Corporation decreased from $98.9 million to $80.4 million due to loan repayments of $18.5 million during the year.

REPORT ON PERFORMANCE

Progress on Strategic Priorities

As a result of a Government policy decision, NMFC discontinued its capital markets borrowing program several years ago with any subsequent municipal requirements to be met through the direct Provincial borrowing program. Consequently, NMFC is currently in the process of gradually winding down its operations through the collection of its outstanding loans receivable and retirement of its remaining debenture debt as it matures. This activity was the focus of NMFC's 2008-11 Activity Plan. As detailed below, NMFC has met its collection and repayment priorities for the 2008-11 fiscal year time frame.

Goal:

By March 31, 2011, NMFC will have executed the collection of loans receivable and payment of debenture debt in accordance with the schedule of planned payments as set out below:

Objective by Fiscal Year	Debt Maturities	Loan Collections
	($ thousands)	
2008-09	$ 28,209	$ 26,659
2009-10	20,466	23,458
2010-11	18,566	20,572

Measure: Net balances of outstanding loans receivable and debenture debt payable reduced by planned amounts.

Indicators:

- Net outstanding loans to municipalities reduced by $70,689,000.
- Net outstanding debenture debt reduced by $67,241,000.

Results of 2008-11 Goal:

- Net outstanding loans to municipalities reduced by $70,965,000.
- Net outstanding debenture debt reduced by $70,250,000.

2008-11 goal of reducing net balances of outstanding loans receivable and debenture debt payable have been met.

Objective:

By March 31, 2011, NMFC will have executed the collection of loans receivable and payment of debenture debt in accordance with the schedule of planned payments and collections for the year.

Measure:

Net balances of outstanding loans receivable and debenture debt payable reduced by planned amounts.

Indicators (amounts in thousands):

- Outstanding loans to municipalities reduced by $20,572.
- Outstanding debenture debt reduced by $18,566.

Results of 2010-11 Objective (amount in thousands):

- Outstanding loans to municipalities have been reduced by $20,469.
- Outstanding debenture debt was reduced by $18,566.

Variance of 2010-11 Objective:

- The amount collected on loans to municipalities was less than forecast as a result of early payouts on loans in previous fiscal years.

OPPORTUNITIES AND CHALLENGES AHEAD

The major challenge for the upcoming year will be the continuing implementation of the strategy agreed to with MA in 2009-10 with respect to outstanding municipal arrears as detailed in the Shared Commitments section.

FINANCIAL STATEMENTS

Management's Responsibility for Financial Statements

The financial statements of the Newfoundland and Labrador Municipal Financing Corporation are the responsibility of management and have been prepared in accordance with Canadian generally accepted accounting principles. The financial information presented elsewhere in the Annual Report is consistent with the financial statements and the underlying information from which the financial statements were prepared.

The Auditor General of Newfoundland and Labrador, appointed as the external auditor under the *Municipal Financing Corporation Act*, performed an audit on the financial statements in accordance with Canadian generally accepted auditing standards. The Auditor's Report attached to the financial statements outlines the scope of the examination and contains the Auditor General's opinion on the Corporation's financial statements.

AUDITOR'S REPORT & AUDITED FINANCIAL STATEMENTS

The audited Financial Statements are attached.

NEWFOUNDLAND AND LABRADOR
MUNICIPAL FINANCING CORPORATION

FINANCIAL STATEMENTS

31 MARCH 2011

Office of the Auditor General

OFFICE OF THE AUDITOR GENERAL
St. John's, Newfoundland and Labrador

AUDITOR'S REPORT

To the Board of Directors
Newfoundland and Labrador Municipal Financing
Corporation
St. John's, Newfoundland and Labrador

Report on the Financial Statements

I have audited the accompanying financial statements of the Newfoundland and Labrador Municipal Financing Corporation which comprise the balance sheet as at 31 March 2011 and the statement of revenues, expenses and surplus, and statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

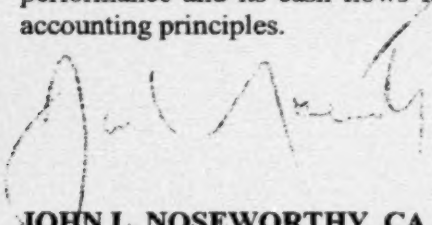
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Auditor's Report (cont.)

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

In my opinion, the financial statements present fairly, in all material respects, the financial position of the Newfoundland and Labrador Municipal Financing Corporation as at 31 March 2011 and its financial performance and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.



JOHN L. NOSEWORTHY, CA
Auditor General

21 July 2011
St. John's, Newfoundland and Labrador

NEWFOUNDLAND AND LABRADOR MUNICIPAL FINANCING CORPORATION

BALANCE SHEET

31 March	2011 (000's)	2010 (000's)
ASSETS		
Current		
Cash and term deposits	$ 4,117	$ -
Investment - coupons (at cost) (Note 2)	344	662
- earned interest receivable	497	803
Accounts receivable	4,502	6,800
Accrued interest receivable	562	765
Current portion of loans receivable (Note 3)	17,907	20,469
	27,929	29,499
Long-term investment – coupons (Note 2)	313	657
Long-term loans receivable (Note 3)	68,316	86,223
Deferred charges (Note 4)	136	200
	$ 96,694	$ 116,579
LIABILITIES AND SURPLUS		
Current		
Bank indebtedness	$ -	$ 985
Accounts payable and accrued liabilities	27	52
Accrued interest payable	391	622
Current portion of debenture debt (Note 5)	25,116	18,566
Current portion of deferred revenue (Note 6)	41	68
	25,575	20,293
Long-term debenture debt (Note 5)	55,262	80,378
Long-term deferred revenue (Note 6)	64	105
Reserve fund (Note 7)	4,727	6,770
	85,628	107,546
Surplus	11,066	9,033
	$ 96,694	$ 116,579

See accompanying notes

Signed on behalf of the Board of Directors:

Chairperson **Director**

NEWFOUNDLAND AND LABRADOR MUNICIPAL FINANCING CORPORATION
STATEMENT OF REVENUES, EXPENSES AND SURPLUS
For the Year Ended 31 March

	2011	2010
	(000's)	(000's)
REVENUES		
Interest on loans to municipal corporations	$ 7,199	$ 9,075
Short-term interest	89	121
Amortization of deferred revenue:		
Prepayment penalties	68	89
	7,356	9,285
EXPENSES		
Administrative and miscellaneous	126	125
Amortization of deferred charges:		
Issue expenses on debenture debt	45	59
Premiums and discounts on debenture debt	19	24
Interest on long-term debt	5,126	6,302
Interest - other	7	53
	5,323	6,563
Excess of revenues over expenses	2,033	2,722
Surplus, beginning of year	9,033	6,311
Surplus, end of year	$ 11,066	$ 9,033

See accompanying notes

NEWFOUNDLAND AND LABRADOR MUNICIPAL FINANCING CORPORATION
STATEMENT OF CASH FLOWS
For the Year Ended 31 March

	2011	2010
	(000's)	(000's)
Cash flows from operating activities		
Excess of revenues over expenses	$ 2,033	$ 2,722
Add (deduct) non-cash items:		
Amortization of prepayment penalties	(68)	(89)
Accrued interest income on coupons	(48)	(91)
Amortization of issue expenses on debenture debt	45	59
Amortization of premiums and discounts on debenture debt	19	24
	1,981	2,625
Change in non-cash working capital	2,245	(523)
	4,226	2,102
Cash flows from financing activities		
Retirement of debenture debt	(18,566)	(20,466)
Reserve fund advances received	-	5,000
Reserve fund allocations made	(2,043)	-
Prepayment penalties received	-	2
	(20,609)	(15,464)
Cash flows from investing activities		
Investment - coupons redeemed	1,016	1,781
Loan payments received from municipal corporations	20,469	23,359
	21,485	25,140
Increase in cash / decrease in bank indebtedness	5,102	11,778
Bank indebtedness, beginning of year	(985)	(12,763)
Cash and term deposits (bank indebtedness), end of year	$ 4,117	$ (985)

See accompanying notes

Authority

Newfoundland and Labrador Municipal Financing Corporation (the Corporation) was created by the *Municipal Financing Corporation Act*. The Corporation was established to provide long-term financing for the capital requirements of municipal corporations by the issuance of its securities, and relending the funds to municipal corporations. The Corporation's affairs are managed by a Board of Directors appointed by the Lieutenant-Governor in Council. All board members are full-time employees of the Province of Newfoundland and Labrador (the Province).

1. Summary of significant accounting policies

These financial statements have been prepared by the Corporation's management in accordance with Canadian generally accepted accounting principles. Outlined below are the significant accounting policies followed.

(a) Premiums, discounts and issue expenses on debenture debt

Premiums, discounts and issue expenses are deferred and amortized on a straight line basis over the life of the debenture issue to which they relate. In the case of the early retirement of debenture debt, a proportionate amount of the deferred balance is included with the gain or loss in the determination of net income for the period.

(b) Deferred revenue

Penalties are charged when municipal corporations prepay all or a portion of their loans with the Corporation. These penalties are deferred and amortized on a straight line basis over the average years remaining for these loans prior to payout.

2. Investments

The short-term portion of investments consists of 28 Government of Canada coupons that were purchased between 30 December 1997 and 22 September 2005, and mature on 1 June 2011 and 1 December 2011. Settlement values of these securities ranged from $106 to $19,292 with a total cost of $344,351 (2010 - $662,215), while maturity values range from $167 to $36,838 and have a total maturity value of $611,755.

The long-term portion of these coupons matures between 1 June 2012 and 1 December 2016. Settlement values of these securities ranged from $103 to $17,523 with a total cost of $312,997 (2010 - $657,348), while maturity values range from $167 to $36,838 and have a total maturity value of $595,165.

3. Loans receivable

	2011 (000's)	2010 (000's)
Loans receivable from municipal corporations	$ 86,223	$ 106,692
Less: current portion	(17,907)	(20,469)
Long-term portion	$ 68,316	$ 86,223

Loans to municipal corporations are made on the security of their debentures. Provisions exist for the recovery from the Province of any defaults by municipal corporations. Therefore, no allowance for doubtful accounts has been provided.

Principal payments receivable in each of the next five (5) years are as follows:

Year	Amount (000's)
2012	$17,907
2013	$16,602
2014	$14,168
2015	$11,643
2016	$ 9,297

4. Deferred charges

	2011 (000's)	2010 (000's)
Issue expenses on debenture debt	$ 97	$ 142
Premiums and discounts on debenture debt	39	58
	$ 136	$ 200

5. Debenture debt

The Corporation's debenture debt is unconditionally and fully guaranteed as to principal, interest and sinking fund payments, if any, by the Province. Details of long-term debt outstanding at 31 March 2011 are as follows:

Series	Remaining Term	Interest Rate %	2011 (000's)	2010 (000's)	
MFC-36			$ -	$ 1,250	
MFC-37			-	2,000	
MFC-38	1 Jun 2011-13	5.875 - 6.000	3,750	5,000	(a)
MFC-39	16 Dec 2011-13	6.000 - 6.125	3,000	4,000	(b)
MFC-40	14 Dec 2011-14	6.800 - 6.850	4,000	5,000	(c)
MFC-41			-	1,000	
MFC-42	5 Apr 2011	5.900	2,500	4,200	(d)
MFC-43	20 Sep 2011-16	6.125 - 6.500	12,800	15,600	(e)
MFC-44	15 Mar 2012-17	5.875 - 6.125	6,000	7,000	(f)
MFC-45	26 Mar 2012-13	5.250 - 5.375	12,000	14,000	(g)
MFC-46	15 Feb 2012	5.200	10,000	10,000	
MFC-47	17 Mar 2012-19	4.550 - 5.200	10,128	11,394	(h)
MFC-48	29 Mar 2012-20	4.550 - 5.200	16,200	18,500	(i)
Total			80,378	98,944	
Less: current portion			(25,116)	(18,566)	
Long-term portion			$ 55,262	$ 80,378	

(a) MFC-38: On 1 June of each year, the Corporation is to redeem $1,250,000 in the years 2011 to 2013 inclusive.

(b) MFC-39: On 16 December of each year, the Corporation is to redeem $1,000,000 in the years 2011 to 2013 inclusive.

(c) MFC-40: On 14 December of each year, the Corporation is to redeem $1,000,000 in the years 2011 to 2014 inclusive.

(d) MFC-42: On 5 April 2011, the Corporation is to redeem $2,500,000

(e) MFC-43: On 20 September of each year, the Corporation is to redeem $2,800,000 in the year 2011 and $2,000,000 in the years 2012 to 2016 inclusive.

5. Debenture debt (cont.)

(f) MFC-44: On 15 March of each year, the Corporation is to redeem $1,000,000 in the year 2012 to 2017 inclusive.

(g) MFC-45: On 26 March of each year, the Corporation is to redeem $2,000,000 in the year 2012 and $10,000,000 in the year 2013.

(h) MFC-47: On 17 March of each year, the Corporation is to redeem $1,266,000 in the years 2012 to 2019 inclusive.

(i) MFC-48: On 29 March of each year, the Corporation is to redeem $2,300,000 in the years 2012 to 2015 inclusive and $1,400,000 in the years 2016 to 2020 inclusive.

Estimated debenture maturities over the next five (5) years are as follows:

Year Ending 31 March	Debenture Maturities (000's)
2012	$25,116
2013	$19,816
2014	$ 9,816
2015	$ 7,566
2016	$ 5,666

6. Deferred revenue

	2011 (000's)	2010 (000's)
Deferred revenue	$ 105	$ 173
Less: current portion	(41)	(68)
Long-term portion	$ 64	$ 105

7. Reserve fund

The Province has historically funded a reserve fund established to mitigate arrears with respect to municipal loans. The reserve fund is allocated as the Department of Municipal Affairs concludes negotiations with various municipal corporations with respect to restructuring debt due to the Corporation.

The year end reserve fund balance is as follows:

	2011 (000's)	2010 (000's)
Reserve fund, beginning of year	$ 6,770	$ 1,770
Add: funds advanced to Corporation during year	-	5,000
Less: funds allocated during year	(2,043)	-
Reserve fund, end of year	$ 4,727	$ 6,770

8. Financial instruments

The Corporation's short-term financial instruments recognized on the balance sheet consist of cash and term deposits, short-term investments, accounts receivable, accrued interest receivable, accounts payable and accrued liabilities, and accrued interest payable. The carrying values of these instruments approximate current fair value due to their nature and the short-term maturity associated with them. Since provisions exist for the recovery from the Province of any defaults by municipal corporations there is no credit risk associated with the Corporation's accounts receivable.

The Corporation's long-term financial instruments recognized on the balance sheet consist of long-term investments, long-term loans receivable and long-term debenture debt. The Corporation's policy is to hold its long-term investments to maturity, therefore their reported value is current fair value to the Corporation. Since provisions exist for the recovery from the Province of any defaults by municipal corporations there is no credit risk associated with the Corporation's long-term loans receivable and therefore, the amount presented in the balance sheet is the same as current fair value of the asset.

The majority of the Corporation's long-term debt is issued as serial debentures which are redeemed over a number of years at varying interest rates. In addition, the Corporation's long-term debenture debt was used to finance loans to the Province's various municipalities. The rates charged by the Corporation to these municipalities were calculated using the rates the Corporation was required to pay on its related debenture debt plus an additional percentage. Because provisions exist for the recovery from the Province of any defaults by municipal corporations and because the long-term debenture debt of the Corporation is specifically tied to these receivables, the long-term debenture debt as presented in the balance sheet is presented at current fair value and the Corporation is not subject to any rate risk relating to this debt.

9. Economic dependence

As a result of cost-sharing arrangements, the loans receivable from municipal corporations disclosed in Note 3 are serviced by both the municipal corporations and the Province. Due to the nature of these arrangements, the Province is in effect repaying a significant portion of the loans owing to the Corporation. Provisions exist for the recovery from the Province of any defaults by municipal corporations.

The Corporation's debentures are fully guaranteed by the Province as to principal, interest and sinking fund payments, if any. As at 31 March 2011, this guarantee covered net debenture debt and accrued interest totalling $80,769,000 (2010 - $99,566,000).

As a result, the Corporation's continued existence is dependent upon the decisions of the Province.

10. Related party transactions

The Corporation is administered by employees of the Department of Finance. The salary costs of these employees are paid by the Department of Finance, reimbursed by the Corporation, and are reflected in these financial statements.

11. Income taxes

The Corporation is a Crown corporation of the Province of Newfoundland and Labrador and as such is not subject to Provincial or Federal income taxes.

12. Planned wind down of operations

The Province of Newfoundland and Labrador has decided that it will no longer refinance its portion of completed municipal capital projects through the Corporation. As a result, the Corporation will be winding up its operations over the coming years as it collects its loans receivable and repays its debenture debt.